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In my Annual report last month I stated that 2011 would provide certain economical and geo-political events which would influence short term sentiments. I had no idea how prophetic these words would become. The world was already expecting a certain amount of headwinds in the second half of the year but the events in North Africa and the Middle East have brought the excitement of change with added uncertainty into the mix. As I write this, Tunisia and Egypt are on the cusp of a "positive democratic renaissance" which the world supports and encourages. The domino effect has... to greater or lesser degrees... impacted all neighboring countries. Whether all others will throw off their autocratic regimes remains to be seen. What is undoubtedly the case is that the spontaneous revolution has begun a process that will be difficult to reverse. To date only Gaddafi in Libya has attempted to fight the unwinnable fight. The sad loss of life of over a thousand Libyans and the real expectation of many more; although tragic, nevertheless offers a palpable indication of the underlying desire for change in the country and throughout the Arabian region.

We inevitably saw a spike in energy costs and unless we see similar events in Saudi Arabia then I expect that further short term spikes will likely be fairly mooted from our current levels. However, it is also obvious, that until current events are resolved that oil will remain high (See Summary). At present it would seem that the other autocratic states are looking to make concessions which may placate, in the short term, the inevitable changes, coming sometime in the future. Today only Libya is really in focus and unless a full civil war occurs, with the added destruction of the plants and pipelines occurring, impacting both the short and the long term 1.8 million barrels per day supply, then it is unlikely that the events will seriously effect global markets. Escalated unrest in Saudi Arabia however, would change that immediately. I believe the region will see slower change than we have experienced over the past few weeks.

Notwithstanding the amazing events above it is Ireland which will hold market watchers attention in the coming weeks, as the unintended consequences of Fridays election could have a systemic impact globally (I have attempted to explain the Irish situation in recent quarterly reviews please read them on our website). Unsurprisingly the ruling Fianna Fail party has been soundly defeating and its ancient opponents Fine Gael, will be the largest party but short of a majority. This will require them to form a coalition with either the labour party (most likely) or Sinn Féin and or find sufficient independents to form a minority party. My first prediction is that whatever government is formed it is more

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likely that it will be shortest in the history of Ireland (60-40%). All of the likely coalition partners have successfully campaigned on the platform to "reschedule the IMF/ECB debt package. The IMF and the European Central bank have stated that the recent loan is not negotiable, however as I discussed in previous reviews, neither the Irish people nor its economy can prosper under its draconian terms. This is especially true politically as only the Irish people are being punished and all investors/bondholders in their failed banks have no capital losses to endure.

Logically and morally this is untenable. However as we discussed in a previous Quarterly report the "rough wooing" of the IMF/ECB had more to do with protecting other European, US and international banks who are the main bondholders.

An actual loss or the perception of possible loss could have a devastating impact on the International banks capital status and subsequently serious hinder the current...fragile... global recovery. An addition difficulty is that Irish politics is somewhat of a family business, with sons and daughters of sitting members taking their parents place on their retirement. This means that the likely new cabinet members, who were for a little time lawyers, social workers, teachers, doctors etc., before taking their parent/s place have sufficient experience to handle the challenges ahead. It is not impos-

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sible, but politically whosoever succeeds to government has a "poisoned chalice" and a very angry electorate which is disillusioned with their Euro membership and any government who offers them a solution where basically they will be punished and others are immune will I believe be short lived.

Germany is likely to bow to pressure and reluctantly support a reduction of the interest level from its present high of 6% (See Below*) but as with the unrest in Africa and the Middle East, people in Ireland are angry and want their newly elected government to reflect their views that the pain should be shared. Whether they succeed or not in their enterprise Sovereign debt issues in the Eurozone will once again be "front and centre" although this time an actual event will fuel the speculation. This changes the matrixes. If no Irish political consensus can be achieved within a coalition then either a specific referendum or a new election must occur. Even if a consensus can be achieved between parties, whether this will be acceptable to their electorate remains moot.
* The final piece of this uncertain "jigsaw puzzle" is that even if the German government is prepared to relax its fiscal discipline to its Eurozone partners; its Constitution Court must rule on an appeal against German support for the Eurozone "bailout Fund". If upheld then both the German government and all debt laden Eurozone countries face both fiscal and economical turmoil.

In any event I expect...for the foreseeable future... debt in the Eurozone will become the topic which the world's financial markets will be focused. During the past year whenever the Euro was so viewed, it inevitably resulted in its fall against other currencies. The challenges ahead are more severe insofar as this focus always brings higher borrowing costs to other Eurozone governments and unless Libya can be quickly brought back to some semblance of normality then Italy could now become the next piig country to come under serious speculative pressure. The ECB and the IMF have had at least three months to prepare for the Irish situation. This will be a test of their ingenuity and resolve. However make no mistake if the events in Africa and the middle east had not occurred then the world would be fully focused on Ireland. The coming weeks will give us some indications of the challenges ahead. If no acceptable political solution is found then Ireland's people will reject not only a revised debt structure but may ask for a referendum on staying in the Eurozone and emotions are such as to suggestion that outcome would be negative. If the IMF/ ECB reschedules the loan then unless an adequate war chest is garnered (as every other financially beleaguered Eurozone government will be forced by their electorate to seek a similar relief) then the Eurozone will face its most challenging test since its inception.

While the Middle East and Ireland hold our immediate focus, the other events we shall encounter in 2011 still offer challenges. Without any of the above circumstance 2011 is the year when government stimulus begins to be withdrawn and austerity programmes implemented to redress untenable debt levels, begin to bite.

No established democracies will experiences any of the events discussed above, never the less as political policies...either driven by ideological or financial necessity... begin to identify specific sectors of their population to lose either income, entitlement or working benefits. Then as we have seen recently in the USA, UK and throughout Europe, between newly elected republican governors and unionized teachers and government workers in the former and varied disadvantaged groups in the latter two; its becoming apparent that everyone wants their government to spend less, but not at their expense. We are therefore unlikely to see innovative balanced programmes being created in the short term to be neither fiscally responsible nor bold enough to implement the necessary proactive national programmes necessary to return adequate growth in their anemic economies.

Although growth exists it is particularly and more importantly, stubbornly, modest and still relatively fragile. Unlike other

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recessions, the unique "financial aspect" of this one has meant that 2% annual growth is being experienced rather than the usual 4-5% . Until established economies can meet and sustain these higher targets, then the chance of reducing unemployment levels is impossible. Indeed in countries such as the USA if current levels of growth is sustained would not even meet the new jobs needed to facilitate demographic increases.

The other demographic item with political implications which the world must address is rising food prices. Although the inevitable outcome of the USA's QE2 programme would be higher prices in commodities bought and sold in USDollars, the main reason is weather. Long lasting droughts in Russia and Argentina combined with floods in Australia have now been augmented by prospect of a severe long lasting drought in China. These natural disasters are normally facilitated by surpluses created by the USA's higher agricultural technological garnered yields. However as 24% of USA's crops are mandated to be used for ethanol they hold the lowest reserves in modern time and are unable to meet other countries shortfalls. Corn prices have nearly doubled since July last year and the world begins next years harvest with no real surplus to mitigate another bad harvest. Subsequently I expect agricultural commodities to remain high for the foreseeable future.

The political implications we see not only as one of the catalysts in recent events in Africa and the Middle East but as an ongoing brake to overall Global growth. Unless price increases can be passed on to consumers then already beleaguered economies come under further pressure. Major manufacturers have to date absorbed rising basic material costs and a number are contemplating 10-20% price increases of their finished products. Whether this exercise will result in greater net profits or merely allow their competitors... whom will hold existing prices... to increase their market share at their expense, has yet to be determined. It is an exercise which will be avidly observed by all major manufacturers.

The next global political and economical forum will be the G8 meeting/s, hosted by France in May and November (G20) which offers a chance for the major players to address current realities. Generally they are anemic affairs, concluded with watered down resolutions. However current events may change this norm. Equally, when these events are hosted by European leaders they traditionally trend towards presenting more philosophical "big picture" proposals. Inevitably they fail to find traction. There are opportune times when actual events can meet good philosophies and never... in the last sixty years... has the world be so poised on the "cusp" of change. President Sarkoys needs this opportunity to re-gild his somewhat tarnished image and many countries, with less that full democracies are more likely to be open for change that at anytime since these forums were established.

SUMMARY

It is likely that Ben Bernanke will, within his two day, quarterly session, present a
"steady as you go" report to the US Senate and Congress. Continued low interest rates and QE2 stimulus, for the foreseeable future. There may even be some suggestion for a QE3 programme. In normal times this would likely affect US Bond yields see the USDollar fall against other currencies and commodity prices soar. In addition inflation fears would increase. However with the current African and Middle Eastern situation still simmering and no sign that even relatively stable countries in the region are immune to imposed citizen changes; the concerns of turmoil and instability negate what otherwise would be a relatively positive trading environment.

While interest rates have been at all times lows, then investment into markets has been considered a better alternative than bank accounts. In addition the many unused trillions in Corporate bank accounts, if not used to expand their workforce, must be used either for acquisition, stock buy backs or distributed as increased dividends has assisted in supporting current market valuations. However if these freedom movements, fuelled by lack of opportunity for predominately large young unemployed citizens expand... and I see no way that they can be subdued... then if a sufficient number of events occur in the short term to bring unacceptable levels of concern and uncertainty then markets could be roiled. A flight to safety could see markets take a 10-12% short term

"haircut" dip.

Just before the 2008/9 crash, markets rose and fell in unison. Similarly through late 2009 and most of 2010. Since then some separation of sectors have prevailed and generally our Portfolio and fund selections have benefitted from these differentials.
Generally, even markets would be glad to see more democratic countries and support these "renaissance" movements. At least those with a "long term" perspective. The difficulties arise, if countries such as Saudi Arabia or China experience similar "large scale" popular movements. Neither ruler will sit quietly for major dissent. Indeed in both countries it is illegal to congregate and demonstrate. In countries such as Oman which is relatively stable, a programmed issued during the past few days to create 50,000 new jobs was not received with acclaim by their citizens but the criticism that if they are doing it now, why didn't they do it before. I have no doubt that autocratic governments throughout the world will seek to placate their disgruntled citizens.

I am equally sure… that at best… this will only delay the inevitable, but in many cases these concessions will spur those seeking change and accelerate the speed as well as the size of the revolutions.

One of the unintended consequences of these events is that many governments will seek to subsidise food and energy cost, restrict exports of basic food and vegetables etc., to placate national dissent. This inevitably will keep global commodity prices high. However, this dilutes their own reserves and is the least productive use of the money, and they are further impacted by the loss in export revenues to their balance sheets. If oil prices sustain or increase in value then it is unlikely that inflation will not creep back into the picture. Additionally if these values are continued over a protracted period then developed countries recoveries and their attempts to reduce fiscal debt are put under considerable pressure. A relatively short but sustained period of inflation would increase yields of US treasuries which would disrupt QE2 stimulus buying and indeed could require the FED to sell previous bought T bills. Although I feel this is unlikely, never the less it adds to the "possible" negative side of consensus.

To balance the above, must be the increased global manufacturing performance which looks to be very robust. Sadly it has come by greater productivity and new technological advances and with little organic growth. However companies holding cash must begin to use it productively or see their P/E ratios suffer. They generally have four options:-

- Share buy back programmes
- Dividend distribution
- Mergers and Acquisition
- Organic growth.

The latter would be better insofar as it would indicate a positive outlook for growth, which would require sustained recruitment; reducing unemployment. Never the less if programmed properly the first two would at least support current valuations and if most current and new democracy events can be resolved quickly…and more importantly… peacefully, then markets could sustain and modestly rally. The history of M&A is not always one of great success, never the less if the acquisition makes sense then once again this will add to positive sentiment. Should the merger or acquisition not be assessed as a quality decision or be viewed as not a great help to unemployment…or even worse… helping another nations employment to the detriment of their home country; then little benefit would be gained. In any event there is little chance that one or more of the four possibilities will not be used and should subsequently be viewed as a positive opportunity.

Therefore we find ourselves in a position whereby ancillary events to business performance and their impacts are somewhat unpredictable. Never the less certain obvious growth areas should continue. Only some relief in the drought expectations in China would undermine food price values for the rest of the year. Unless some of the strategic oil reserves held in the EU and the USA are released to mitigate further rises in the cost of oil…which I believe is unlikely unless Saudi Arabia supply is considered vulnerable…or price reach $125USD per barrel then food and commodity prices are likely to generally be sustained. We may experience occasional retreats in values but in the main, it

is oil rich countries/areas which suffer from entrenched undemocratic governments. Subsequently I see the continued "freedom" movements providing enough momentum to provide an ongoing focus on the sector to generally keep prices high. This will impact both established and emerging countries. However, much more in the latter. In addition these are the countries more vulnerable to better governance revolts. Therefore the dilemma is how to balance our investment strategy to best handle the above, very variable conditions.

In the short term, now that sectors are more disconnected, it is not unexpected that established country markets will be negatively affected by high oil and basic material prices. This would be the expected economical consequences and if we add Middle Eastern and other area concerns then the flight to gold and silver and away from copper is logically quite acceptable. Equally if oil falls back then the main indices would likely rise unless an unrelated event occurs to spook the markets. If we delve into the recent manufacturing increase we see that it is mainly cars. In the USA and Europe, car sales are down dramatically but Latin America, China and other emerging markets are buying all that the major car manufactures can make; especially the small and luxury brands. However this demographically and income led growth, is only sustainable if emerging countries are not burdened with higher inflation and/or undergoing major political or civil unrest.

Therefore there are sufficient reasonable reasons to hold either a bullish or bearish philosophy. It will be those unpredictable events which could quickly change sentiment. Markets generally never fall precipitously from recent high positions. They do from a lower recent high. IE when they fall from a high and recover part way back up. Certain sectors of current markets are likely to reach such a position. The difficulty is to determine whether this is a momentum move which will consolidate and pass through recent highs or whether they reach only part way and become vulnerable to negative events and correct. At these times the best strategy is to "hedge". For example those with a high industrial allocation should hold oil and energy as the growth of either is to the detriment of the other.

In the case of most of our Vision and Viva etc., clients with a well diversed allocation strategy, the hedge already exist. However those with a small diversity should contact us to discuss possibilities.

In the case of our portfolio clients we hold a large part of each in cash. This allows an advantage in so far as one can hedge Middle Eastern and even emerging markets (The likely areas of continued political unrest and change) against oil. One could also hedge gold and silver with S&P500. This allows the gain to be reinvested into loser to gain its eventual return. The examples could easily be oil with copper as the former holds back emerging market growth or indeed political unrest, which will curb internal growth and reduce construction demand. Therefore copper could be used to hedge US housing although other global demand could distort it at the edges.

For the more patient and less aggressive they are equally well placed to buy short term oversold sectors in the dips.

The aggressive portfolio investor can even short, directly, certain sectors with, if desired, multiple leverage ratios.
Inverse (Short) Market Cap ETFs
ProShares Short QQQ ETF (PSQ)
ProShares Short S&P500 ETF (SH)
ProShares Short MidCap400 ETF (MYY)
ProShares Short Dow30 ETF (DOG)
ProShares Short Russell2000 ETF (RWM)
ProShares Short SmallCap600 ETF (SBB)
Leveraged Inverse (Short) Market Cap ETFs
ProShares UltraShort QQQ ETF (QID)
ProShares UltraShort S&P500 ETF (SDS)
ProShares UltraShort MidCap400 ETF (MZZ)
ProShares UltraShort Dow30 ETF (DXD)
ProShares UltraShort Russell2000 ETF (TWM)
ProShares UltraShort SmallCap600 ETF (SDD)
Rydex Inverse 2x S&P 500 ETF (RSW)
Rydex Inverse 2x S&P MidCap 400 ETF (RMS)

Rydex Inverse 2x Russell 2000® ETF (RRZ)
Direxion Russell 1000 Bearish 3X ETF (BGZ)
Direxion Russell 2000 Bearish 3X ETF (TZA)

International Shorts

(AMEX: EUM) and UltraShort (AMEX: EEV) * ETFs tied to the MSCI Emerging Markets Index
Those funds joined the Short MSCI EAFE (AMEX: EFZ) and the UltraShort MSCI EAFE (AMEX: EFU)* ETFs,
UltraShort MSCI Japan (AMEX: EWV)*
UltraShort FTSE/Xinhua China 25 (AMEX: FXP) funds*.

Subsequently, the current political and philosophical revolutionary events occurring around the world even although welcomed by most people are not so helpful for the investor in the short term. In a way the ease of transition in Tunisia and Egypt has stimulated mirror events in higher autocratic countries which either are strong enough to fight the obvious or are willing to use overwhelming force at the outset to restrict momentum. These are events which are impossible to either time or define the outcome. More importantly what impact they would have on markets. In our coming quarterly Review in early April we shall look at the likely long term beneficiaries of these events and our assessment of both short and long term winners and losers. Until then we shall email directly our Portfolio clients to assess their preference.

Regards
Robert Alan Lamb